IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1073

FIRST NATIONAL BANK OF OREGON, a national banking association, *Petitioner,*

v.

AMERICAN TIMBER & TRADING CO., an Oregon corporation, LAWRENCE BERNARD, individually and DR. LAWRENCE BERNARD, Professional Corporation, ET AL., *Respondents.*

MOTION FOR LEAVE TO FILE A BRIEF ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

On February 26, 1975, the First National Bank of Oregon, the defendant in the trial court, filed a petition for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit. The American Bankers Association, considering that the decision of the Court of Appeals conflicts with positions taken in

opinions of this Court [1] and is erroneous, wishes to file a brief in support of the petition. The Petitioner has consented to the filing of such a brief, but the Respondents have declined to consent. Accordingly, the Association moves pursuant to Rule 42 of the Supreme Court for leave to file the attached brief in support of the petition for certiorari.

INTEREST OF AMICUS CURIAE

The American Bankers Association is a trade association having as members more than 13,500 commercial banks, including about 4,600 national banks and about 8,900 State-chartered banks, over 95 per cent of the entire commercial banking system of the United States.

The National Bank Act permits national banks to charge interest rates permitted by State usury statutes—with several exceptions—and provides for forfeiture of unpaid interest and a penalty of twice the amount of any interest paid. Neither the National Bank Act nor the Oregon usury statutes, however, prescribes how the interest charges on loans are to be computed when the applicable maximum interest rate has been ascertained.

There are three methods of computing interest charges: the 365/365 basis, sometimes called the "exact" or "true" rate; the 365/360 basis, sometimes called the "bank" rate; and the 360/360 basis.

The 365/360 basis of computing interest, which results in an effective interest rate or yield 1/72 more

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[1] *Tiffany* v. *National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 21 L.Ed. 862 (1874); *Evans* v. *National Bank of Savannah*, 251 U.S. 108, 40 S.Ct. 58, 64 L.Ed. 171 (1919).

than the 365/365 basis, has been widely used by banks in the United States since 1800. The 365/360 basis has been approved by the Congress in two instances, by State legislatures, by State court decisions, by legal authorities and by textbook writers. A Federal Reserve Board survey conducted in 1971 indicated that up to 10,000 banks—virtually all of them members of this Association—used the 365/360 basis in connection with one or another kind of loan.

While it is not possible to predict with any degree of accuracy the results of the decision of the Court of Appeals in this case, it seems clear that to prohibit—and to penalize severely—a practice so long-continued and so widespread might well have severe consequences to the commercial banking industry and to its customers, both borrowers and depositors.

POSITION OF THE AMERICAN BANKERS ASSOCIATION

The American Bankers Association makes no recommendations as to what basis of computing interest its member banks should use. However, the Association takes the position that if the 365/360 basis is to be prohibited, as a matter of public policy, this change should be brought about prospectively by legislation—Federal or State as may be appropriate—not retroactively by judicial decision.

MATTERS TO BE SPECIALLY COVERED IN THE BRIEF

In connection with the consideration of this case by the Court of Appeals, this Association undertook extensive research into the history and background of the 365/360 basis of computing interest. In addition, this Association has participated in a number of legislative

proposals relating to interest rates, including particularly the proposals leading to the enactment of Public Law 93-501 on October 29, 1974. This statute amended the National Bank Act and other statutes so as to permit all Federally insured banks, including national banks, and all Federally insured savings and loan associations to charge up to 5 per cent above the applicable Federal Reserve bank discount rates (8 per cent on October 29, 1974, permitting an interest rate up to 13 per cent; reduced on February 4, 1974 to 6¾ per cent, permitting an interest rate of 11¾ per cent). The American Bankers Association considers that it would be appropriate for the Association to bring the results of this research and the implications of Public Law 93-501 to the attention of the Court.

The American Bankers Association respectfully requests leave, therefore, to file the attached brief as Amicus Curiae in support of the petition for a writ of certiorari in the above case.

Respectfully submitted,

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March 6, 1975

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BRIEF ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

QUESTION PRESENTED FOR REVIEW

Whether it was a violation of the National Bank Act (12 U.S.C. §§ 85 and 86) for the First National Bank of Oregon to compute interest on the 365/360 basis on two corporate loan agreements providing for interest paid monthly at the rate of 12 per cent per annum and on one individual loan agreement providing for interest paid monthly at the rate of 10 per cent per annum—12 per cent and 10 per cent per annum being the respective maximum rates permitted for loans to corporations and individuals under Oregon Revised Statutes § 82.010 at the dates these loan agreements were executed.

STATEMENT OF THE CASE

On November 13, 1968, the American Timber and Trading Co. ("AT&T Co."—Respondent), a corporation, executed a loan agreement secured by accounts receivable with the First National Bank of Oregon ("the bank"—Petitioner). This agreement provided for interest payable monthly at the rate of 7½ per cent per annum, with the principal payable on demand. On January 29, 1970, by a supplemental letter, the interest rate was increased to 12 per cent per annum, "computed on the daily debit balances in the borrower's loan account". On January 30, 1970, the daily debit balance was $707,623.91.

On November 18, 1965, Dr. Lawrence Bernard (Respondent), an individual, executed a loan agreement with the same bank secured by accounts receivable which bore interest payable monthly at the rate of 10 percent per annum, with the principal payable on demand. On April 1, 1970, this agreement was superseded by an agreement with Dr. Lawrence Bernard, P.C. (Respondent), a professional corporation. This agreement bore interest payable monthly at the rate of 12 per cent annum with the principal payable on demand. On April 1, 1970, the amount outstanding on this agreement was $107,365.65.

Under Oregon Revised Statutes § 82.010, at the time these agreements were executed the maximum interest rate permitted for loans of this size to individuals was 10 per cent per annum and for loans to corporations 12 per cent per annum.[1] The Oregon statute does not expressly prescribe how these rates are to be applied, nor does any Oregon judicial decision.

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[1] Oregon has since amended its laws to eliminate interest ceilings on loans of the size involved in this litigation. See page 22 below.

12 U.S.C. §§ 85 and 86 provide generally that national banks may not charge higher interest rates than State laws permit; they do not prescribe how the specified interest rates are to be computed.

In accordance with its customary practice for commercial loans and in accordance with the rules set forth in its *Standard Practice Manual,* the bank computed interest on these three agreements on the 365/360 basis, resulting in an effective rate, or yield, of 10.139% on the individual loan and of 12.167% on the corporate loans.

This action was commenced by AT&T Co. as a class action on October 15, 1970. On December 30, 1970, Dr. Lawrence Bernard and Dr. Lawrence Bernard, P.C., moved to intervene as plaintiffs and their motion was granted on November 15, 1970. On May 3, 1971, the District Court held that this case should proceed as a class action, but withheld sending notices to other members of the class.

On December 6, 1971, the District Court decided, on the basis of opposing motions for partial and full summary judgment, that the bank had violated 12 U.S.C. § 86, and on December 20, 1971, the District Court certified that this issue of law was appropriate for interlocutory appeal.

On November 20, 1973, the United States Court of Appeals for the Ninth Circuit handed down a decision affirming the District Court's ruling. On December 2, 1974, the Court of Appeals denied a motion for a rehearing, either by the panel which considered the appeal or by the entire Court en banc.

METHODS OF COMPUTING INTEREST

The Gregorian Calendar creates many complexities for those who transact business on a periodic basis. Its four 30-day months (September, April, June, and November), seven 31-day months (January, March, May, July, August, October, and December), and one month of either 28 or 29 days (February), give a calendar first half year of 181 days (182 in leap year) and a second half of 184 days, and calendar quarters of 90 (91 in leap year), 91, 92, and 92 days.

Any payment made on an equal monthly, quarterly, or semiannual basis, whether of salary, rent, or interest, gives different daily rates for the unequal months, quarters, or half years. On the other hand, any equal daily, weekly, or fortnightly rate for salaries or wages, rents, or interest gives different totals for unequal months, quarters, and years.

The complexities which result from the Gregorian Calendar have given rise to three methods of computing interest, generally called the 365/365 basis, the 365/360 basis, and the 360/360 basis.

Under the 365/365 basis the total interest for one year is computed by multiplying the principal by the nominal interest rate; this annual simple interest figure is divided by 365 (or 366 in a leap year) to get the daily interest; and the daily interest is multiplied by the number of days involved. The 365/365 basis produces different interest figures for 28-day, 29-day, 30-day, and 31-day months, and for quarters and half years of different lengths. This method of computing interest is sometimes described as the "strict" or "exact" or "true" interest rate.

Under the 365/360 basis the total interest for one year is computed by multiplying the principal by the nominal interest rate; this annual simple interest is divided by 360 to get the daily interest; and this daily interest is multiplied by the exact number of days involved up to a total of 365 days for the entire calendar year. This increases the effective interest rate by 5/360, or 1/72nd, over the 365/360 basis. This method of computing interest is sometimes described as involving a "360-day year" or "30-day month," or as the "bank rate". This method was incorporated in the first edition of *Rowlett's Tables of Discount, or Interest,* published in 1802, and in the many succeeding editions of the *Tables.*

The 360/360 basis of computing interest divides the year into 12 months of 30 days each, representing a total of 360 days. These months are treated as 1/12 of a year, and 1/12 of a year's interest is charged for each month, ¼ of a year's interest for each 3-month period and ½ of a year's interest for 6 months. At the end of a year, exactly one year's interest has been earned. This gives equal interest figures for each month, but of course different daily interest figures, for instance, in the three consecutive months of February, March and April. If interest is earned for a number of days in excess of any month or months, interest for those excess days is computed either on the 365/365 basis or on the 365/360 basis. The 360/360 basis is sometimes described as a "360-day year" or a "30-day month", which can result in confusion with the 365/360 basis.

The American Bankers Association makes no recommendation as to what method of computing interest banks should use, considering that this is a matter

solely up to the discretion of each individual bank except, of course, in States where legislation or judicial decision specifically prohibits or specifically prescribes one method or another.

THE POSITION OF AMICUS CURIAE

The American Bankers Association respectfully submits that the Court below erred in interpreting the National Bank Act so as to prohibit—and severely penalize—a custom (the 365/360 basis of computing interest at the statutory maximum) which had been widely followed for 60 years or more before the enactment of that Act, with the approval of State courts, State legislatures, and the Congress, and which has been widely followed for the past century, with the approval of legal scholars and authorities.

The American Bankers Association respectfully submits that if this custom is to be prohibited as a matter of public policy, the change should be accomplished prospectively by State or Federal legislation amending the Oregon usury statute or the National Bank Act, rather than accomplished retroactively by judicial decision. The Association notes that neither the Oregon nor the Federal statute has been amended to accomplish this objective. On the contrary, both State and Federal statutes have been amended since this case was instituted so that today the loans involved would be exempted from the Oregon usury statute, and they would have been within the interest rates permitted under the National Bank Act and P.L. 93-501 from October 29, 1974 to February 4, 1975.

INTEREST OF AMICUS CURIAE

The American Bankers Association is a trade association having as members more than 13,500 commercial banks, of which about 4,600 are national bank-

ing associations—commonly called national banks—chartered under and deriving their powers from the National Bank Act and about 8,900 are State or District banks chartered under and deriving their powers from the laws of the several States and the District of Columbia. These banks comprise virtually the entire commercial banking system of the United States.

One of the primary functions of the commercial banking system is to accumulate funds entrusted to banks by depositors and to lend these funds to industrial and commercial firms, to governmental bodies, and to individual members of the public. On June 30, 1974, the commercial banking system had outstanding approximately $530 billion of loans and discounts, including about $180 billion of commercial and industrial loans, $125 billion of real estate loans, $105 billion of consumer loans, and $120 billion of other loans.

Interest rates on these vast amounts of loans are controlled primarily by the appropriate State usury laws, which apply generally to national banks by virtue of the National Bank Act.[2]

The consequences to the banking industry if the 365/360 basis for computing interest when applied to loans

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[2] 13 Stat. 99, § 30; R.S. §§ 5197 and 5198; 12 U.S.C. §§ 85 and 86. There are several exceptions to the general principle that national banks follow State usury laws. Section 46 of the National Currency Act of 1863, 12 Stat. 665, the predecessor of the National Bank Act, and the House version of H.R. 395, 37th Congress, which became the National Bank Act, expressly authorized taking interest in advance and charging an exchange discount, regardless of State law. See footnote 24 below. See *Tiffany* v. *National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 411-3, 21 L.Ed. 862, 863-4 (1874).

Section 25 of the Banking Act of 1933 inserted a provision in 12 U.S.C. § 85 which authorizes national banks to charge 1 per cent over the discount rate of the appropriate Federal Reserve bank,

at the maximum legal rate is held to violate the National Bank Act could be extremely serious. Under 12 U.S.C. § 86, national banks forfeit any unpaid interest, and if interest has been paid, twice the amount paid could be recovered by the debtor. Under Oregon Revised Statutes § 82.120(1)(5), applicable only to State banks in Oregon, the entire debt is forfeited to the appropriate county school fund.[3]

In 1971, the Chairman of the House Banking & Currency Committee requested the Federal Reserve Board to make a survey of the methods used by banks to

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regardless of State law. See *Problems Encountered under State Usury Laws*, Hearings of a Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, on S. 3817, 93rd Congress, July 31, 1974, pages 102-113, for opinions and discussion of this provision.

Public Law 93-501, approved October 29, 1974, amended 12 U.S.C. § 85 and other statutes to permit Federally-insured banks and savings and loan associations to charge up to 5 per cent over the Federal Reserve bank discount rate on business and agricultural loans of $25,000 or more, regardless of State law. At the date of enactment the discount rate was 8 per cent, permitting an interest rate up to 13 per cent; the discount rate was reduced on February 4, 1975 to 6¾ per cent.

[3] Clearly there is a sound basis for the conclusion that 12 U.S.C. §§ 85 and 86, and even more the Oregon usury statute, are penal statutes, and should be strictly construed. Mr. Justice Strong, speaking for the unanimous court in *Tiffany* v. *National Bank of* Missouri, 85 (18 Wall.) U.S. 409, 410; 21 L.Ed. 862, 863 (1874) made this clear:

> In an action like the present, brought to recover that which is substantially a statutory penalty, the statute must receive a strict, that is, a literal construction. The defendant is not to be subjected to a penalty unless the words of the statute plainly impose it.

See also *Planters Bank* v. *Snodgrass*, 5 Miss. 573, 621. 4 Haw. 573 (1840):

> Our statute against usury is penal, since it inflicts a loss of the entire interest, legal as well as usurious, upon the lender. And it is not the less a penal law because it does not provide for the whole debt, or visit the offenders with fine and imprisonment.

compute interest on their loans. Approximately 82 per cent of the banks responding to this survey reported using the 365/360 basis for computing interest on one kind of loan or another.[4] If the sample selected by the Board for the survey accurately reflects the entire commercial banking industry, this would mean that in 1971 more than 10,000 commercial banks were using the 365/360 basis on one kind of loan or another.[5]

As might be expected from the results of this survey, this issue is a matter of wide national interest. We have been advised that at least 6 other suits have been instituted in Federal courts and 19 suits have been instituted in State courts, in 8 different States, involving various issues relating to the 365/360 basis of computing interest, for example, usury under the National Bank Act or State statutes, disclosure under the Truth in Lending Act, or contractual issues. While many of these suits have been settled during the period this suit has been under consideration, the first decision of a U.S. Court of Appeals on this issue is of great importance to most of the Nation's banks and their customers, not just to the First National Bank of Oregon and those business firms and businessmen which have received loans from that bank on which interest has been computed on the 365/360 basis at the maximum legal rate.[6]

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[4] 117 Cong. Rec. 18538, June 7, 1971.

[5] Since the survey results indicate that the custom is less frequently used among smaller banks than among large banks, the number of banks using the 365/360 basis may be somewhat smaller than 10,000. Nevertheless, Chairman Patman was undoubtedly correct in stating that the practice was widespread.

[6] The only decision on the merits of the use of the 365/360 basis in any of the above cases of which we are aware was *Holisak* v. *Northwestern National Bank of St. Paul*, 210 N.W.2d 413 (Minn., 1973) where the Court held that a Minnesota statute authorized the use of the 365/360 basis.

ARGUMENT

I

The Bank Custom of Computing Interest on the 365/360 Basis Received the Approval of State Legislatures and the Congress, of the Majority of State Courts, of Legal Scholars and Commentators, and of the Writers and Preparers of Textbooks and Interest Tables Over the Past 170 Years

The practice of computing interest on the 365/360 basis has long been common in the United States. The Bank of North America, chartered by the Continental Congress in 1781 [7] and later by Pennsylvania, engaged in this practice, both when the nominal interest rate was below and when it was at the 6 per cent per annum ceiling permitted under its charter. This was reported by John Rowlett [8] who published the first edition of *Rowlett's Tables of Discount, or Interest* in 1802. These early Rowlett interest tables contain almost 157,000 calculations of interest, using the 365/360 basis for its daily calculations running up to 64 days, while monthly interest calculations are on the basis of 30-day months and 360-day years. *Rowlett's Tables* states that all calculations are "performed according to the equitable principles of the Banks, and as practised between individuals throughout the United States".[9]

The first Bank of the United States, chartered in 1791,[10] and the second Bank of the United States,

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[7] Federal Banking Laws and Reports, 1780-1912, Committee Print, Senate Banking and Currency Committee, 86th Congress, 1st Session, March 15, 1963, pp. 1-5.

[8] John Rowlett, *Rowlett's Tables of Discount or Interest* (Philadelphia: C. Sherman & Co., 1833), p. 1.

[9] John Rowlett, *Rowlett's Tables of Discount, or Interest* (Philadelphia: Hugh Maxwell, Columbia House, 1802), Title page.

[10] 1 Stat. 191, Federal Banking Laws and Reports, 1780-1912, p. 66.

chartered in 1816,[11] also computed interest on the 365/360 basis. Both bank charters provided that the banks should not "take more [interest] than at the rate of six per centum per annum for or upon its loans or discounts".[12]

During the 17th Congress, the question arose "whether the [second] Bank of the United States has not taken, and is not in the practice of taking more than six per cent" interest.[13] A special Congressional Committee formed to consider the question found nothing in the "modes of computing interest adopted by the Bank, which calls for legislative interposition. . . ." In its March 1822 report the Committee stated:

> . . . [I]t is, and from the establishment of the Bank of the United States has been, the practice of that Bank, in calculating the discount upon a note payable a certain number of days after the date, to compute the interest upon a month of thirty days, and the fractions of such a month; thus one per cent, is charged for sixty days.
>
> In this respect the Bank has conformed to the established and it is believed, universal usage in the United States, prevailing among Individuals, as well as in monied Institutions, and to the *most approved tables* heretofore in use.[14]

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[11] 3 Stat. 266, Federal Banking Laws and Reports, 1780-1912, p. 127.

[12] Federal Banking Laws and Reports, 1780-1912, pp. 70, 135.

[13] U.S. Congress, House of Representatives, Select Committee on the Memorial of the Bank of the United States, Report, 17th Congress, 1st Session, Congressional Serial No. 70, Report No. 59, 1822; John Rowlett, *Rowlett's Tables of Discount or Interest* (Philadelphia: C. Sherman & Co., 1833), p. 1.

[14] *Ibid.*

The Committee specifically noted that the method of calculating interest based upon a 30-day month "makes a difference of five days in the year, which at six per cent *per annum*, is equal to no more than *eight cents per cent for the whole year*, and is adopted, generally, more to avoid the difficulty of computation at greater precision, than in consideration of either the gain or the loss of such a trifle, whether to a Bank-stockholder, or Borrower." [15]

The methods of computing interest on loans, within the statutory ceilings, have generally not been specified in the usury laws, though there have been a number of cases where the use of *Rowlett's Tables* or the 365/360 basis was specified in statutes or charters.[16] In other instances, the use of the 365/360 basis was approved by judicial decision, in the absence of any specific statutory authorization.[17]

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[15] *Ibid.*

[16] Rowlett's 1833 edition of his *Tables* quotes statutes enacted in Connecticut, Maryland, Kentucky, and Indiana, and by the Congress in its role as legislator for the District of Columbia, which specifically authorized banks to use his *Tables*. In other cases individual bank charters specifically authorized either the 360-day basis, such as the charter of the Bank of North America, or the use of *Rowlett's Tables*. See 1833 edition of *Rowlett's Tables*, p. 1, and 1842 edition, p. 11.

[17] Numerous cases to this effect, and a few to the contrary, are cited in the footnotes to *Williston on Contracts*, § 1693A, and *Corbin on Contracts* § 1504, and in *Paton's Digest of Legal Opinions* Volume II, page 2531ff, and the annotation in 35 ALR 2d 842 cited at page 14 below.

The 365/360 basis for computing interest was approved and recommended in a large number of arithmetic books written during the 19th century.[18]

Williston recognizes and accepts the 365/360 basis for computing interest, even at the maximum legal rate.

> § 1693A. *The Computation of Interest; Periodic Payments.* Custom and convenience have prevailed over strict logic in the generally accepted rule that it is not usurious to calculate interest in accordance with the usual practice on the assumption that there are only 360 days in a year, or 30 days in a month, although the rate is the highest legally permissible.
>
> A few very old cases held that the computation of interest on the basis of 360 days in a year or 30 days in a month was usurious, but only one case in this century has been found which clearly refuses to treat a year as 360 days or as 12 periods of 30 days each.[19]

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[18] For example, see Francis Grund, *Exercises in Arithmetic for the Use of Schools* (Boston: Carter, Hendee and Co., 1833), p. 115; Claudius Crozet, *Arithmetic for Colleges and Schools* (Richmond, Va.: Drinker and Morris, 1848), p. 263; R. C. Smith, *Smith's Inductive Arithmetic* (New York: Daniel Burgess & Co., 1854), p. 135; Philotus Dean, A.M., *Intermediate Arithmetic* (Pittsburgh: A.H. English & Co., 1865), p. 246; Willie Knowlton, *Progressive Simple Interest Treatise* (Victory, New York: Messenger Co., 1875), p. 6. See also James Avery Webb, *A Treatise on the Law of Usury and, Incidentally, of Interest* (St. Louis: FHT Lamas Law Book Co., 1899), Sec. 137, p. 153; 1 Kester *Accounting: Theory and Practice* (2nd Ed.) 1922, p. 196; Eli Farnham, *Farnham Interest Tables* (Butler, Ind.: Farnham Publishing Co., 1931); Montgomery, *Auditing: Theory and Practice* (6th ed.) 1940, p. 475. The Library of Congress contains many other books taking the same position, along with a few which recommend against the use of the 365/360 basis.

[19] *Williston on Contracts*, 3d Edition (1972) page 762. See also 6 *Williston on Contracts* § 1695, 2d Edition (1938). Citations omitted.

Corbin accepts the same view.

> § 1504 A loan may appear to be usurious because interest is calculated by counting a year as having only 360 days; this inaccuracy is disregarded.[20]

The *Restatement of the Law of Contracts,* Volume 2, § 534(c) (1932) is in accord:

> A bargain is not usurious because of the payment or promise of payment of interest for fractions of a year calculated at the highest permissible rate on the assumption that there are only 360 days in the year.

The second edition of American Law Reports, Annotated, issued in 1954, contains an extensive annotation entitled *Computing interest on basis of 360 days in a year, 30 days in a month, or the like as usury* (35 ALR2d 842). This annotation summarizes its conclusions at page 843 as follows:

> So, although there is some authority to the contrary, the courts have generally held that the computation of interest on the basis of 360 days in the year or 30 days in the month is not usurious. In a number of cases, it seems that such a method of computation is not usurious, if done in good faith, without intent to violate the usury law. And in some jurisdictions, such a mode of computation has been legalized by statute. However, in a few cases it has been held that the computation of interest on the basis of 360 days in the year or 30 days in the month is usurious, although in Indiana and New York there are contrary decisions under the small or petty loans act. (citations omitted)

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[20] 6A *Corbin on Contracts,* p. 695 (1962). Citations omitted.

This is followed by four sections footnoted to the above text containing numerous citations under four captions:

§ 2. *View that it is not usury.*

§ 3.—*Under small loan acts.*

§ 4.—*Under specific provisions.*

§ 5. *View that it is usury.*[21]

Paton's Digest (1942),[22] Volume II, Interest and Usury, contains the following general discussion of the topic:

§ 14. *Computation on 30-day Month Basis as Constituting Usury.*

The validity of a bank custom to compute interest on the basis of 30 days to a month has been recognized by a majority of courts.[1] Thus, in calculating the interest on a note, payable six months after date, where the actual number of days from the date of the instrument to the date of maturity is 183 days, a bank's computation of interest for six and one-tenth months on the 30-day month basis is not usurious in states recognizing the 30-day basis.[2]

The charging of interest slightly in excess of the highest lawful rate, due to the use of the 30-day month basis of computation, as a matter of convenience, is generally not regarded as usurious.[3]

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[21] 35 ALR 2d 843-852.

[22] *Paton's Digest:* A Digest of Legal Opinions prepared by the General Counsel of the American Bankers Association and his staff, being a revised, enlarged, and rearranged Publication of the 1926 Edition of the Legal Opinions of the late Thomas B. Paton, formerly General Counsel of the American Bankers Association, on Practical Banking Problems. New York City, 1942.

The footnotes refer to the following Opinions, each of which is extensively annotated:

> 14.1 *Opinion: The validity of a bank custom to compute interest on the basis of 30 days to a month has been recognized by a majority of the courts. The practice is sanctioned by statute in some states.*
>
> 14.2 *Opinion: In states allowing banks to base interest charges on a 30-day month, the bank's computation of interest would not result in usury.*
>
> 14.3 *Opinion: Where, as a matter of convenience in calculating interest, the computation of interest is based on a 360-day year, or a 30-day month, no usury thereby exists, according to some court decisions and under the statutes of some states. Furthermore, the innocent taking of interest slightly in excess of the highest lawful rate, in accordance with the custom of computing interest on such basis, is generally not regarded as usurious.*

It is submitted that the National Bank Act and the Oregon usury statutes, which are silent with respect to the basis for computing interest, should be interpreted so as to permit—not to penalize—a widespread custom which has had such long continued and such highly respected approval.

II

A Commonly Accepted Custom May be Used by a National Bank in Applying a State's Nominal Interest Rate, Even Though This Results in a Slightly Higher Effective Interest Rate Than the Nominal Rate

While this Court has not had occasion to consider the effect of the 365/360 basis in a usury case under 12 U.S.C. §§ 85 and 86, it has in two cases sustained the use of an equally common custom—taking interest in

advance—in situations involving about the same increase of effective rate over the nominal rate,[23] and it has held that this did not violate the law, even when the maximum legal rate was involved.

In *Fleckner* v. *Bank of the United States,* 22 U.S. (8 Wheat.) 338 (1823) the Bank's charter imposed a ceiling of 6 per cent per year on the Bank's interest rates.[24] The Bank discounted a note which had 6 months to run, taking interest in advance at the ceiling rate of 6 per cent a year. The Court held that this did not violate the Bank's charter, and, in an opinion by Mr. Justice Story referring to "the settled practice of banks", based the decision on the ground that this practice was believed to be "universal". The Bank's charter did not include any reference to State usury laws, so the only issue involved was the effect of the limitation contained in the charter.

In *Evans* v. *National Bank of Savannah,* 251 U.S. 108, 40 S.Ct. 58, 64 L.Ed. 171 (1919), a national bank collected interest in advance on short-term notes bearing interest at the maximum rate stated in the Georgia usury law. The Georgia statute did not specify how

[23] The following table shows the variations in effective interest rates or yields resulting from use of the 365/360 basis and payment of interest in advance on one-year single payment loans:

Nominal Rate	365/360 Basis	Payment in Advance	Excess of Rate for Payment in Advance over 365/360 Basis
4%	4.056%	4.167%	.111%
5%	5.069	5.263	.194
6%	6.083	6.383	.300
7%	7.097	7.527	.430
8%	8.111	8.696	.585
10%	10.139	11.111	.972
12%	12.167	13.636	1.469

[24] 3 Stat. 266.

the rate was to be computed. For some time taking interest in advance at the maximum rate was held not to be usurious, but in *Loganville Banking Company* v. *Forrester,* 143 Ga. 302, 84 S.E. 961, L.R.A. 1915D 1195 (1915), the Georgia Supreme Court reversed this ruling and held the practice a violation of the Georgia law. When the case came to the Georgia Court of Appeals, under the name of *Cooper* v. *National Bank of Savannah,* 21 Ga. App. 356, 94 S.E. 611 (1917), the Court recognized the Georgia rule, but held that the *Fleckner* decision took precedence, and decided in favor of the bank.

When the case came before this Court, the Court recognized that the Georgia law, as set forth in the most recent case, would have made the loan usurious for a Georgia bank. Nevertheless, the majority, quoting from Mr. Justice Story's opinion in *Fleckner* v. *Bank of the United States,* supra, concluded that an ancient and commonly accepted doctrine, which was the prevailing practice in business, was not usurious under the National Bank Act.[24] The opinion by Mr. Justice McReynolds concluded:

> Associations organized under the National Bank Act are plainly empowered to discount promissory notes in the ordinary course of business. To discount, ex vi termini, implies reservation of interest in advance: and, under the ancient and commonly accepted doctrine, when dealing

[24] A persuasive argument can be made, on the basis of the legislative history of section 30 of the National Bank Act (12 U.S.C. § 85) that the authorization to take interest in advance contained in the second sentence of the section applies to the interest computed under the first sentence. Apparently this argument was not presented to the *Evans* court, since it is clear that the opinions rest entirely on the basis of bank custom and usage, not on an interpretation of the statutory provision.

> with short-time paper such a reservation at the highest interest rate allowed by law is not usurious. Recognizing prevailing practice in business and the above-stated doctrine concerning usury, we think Congress intended to endow national banks with the power, which banks generally exercise, of discounting notes, reserving charges at the highest rate permitted for interest. To carry out this purpose, the National Bank Act provides that associations organized under it may reserve on any discount interest at the rate allowed by the state; and only when there is reservation at a rate greater than the one specified does the transaction become usurious.
>
> The maximum interest rate allowed by the Georgia statute is 8 per centum. That marks the limit which a national bank there located may charge upon discounts; but its right to retain so much arises from Federal law. The latter also completely defines what constitutes the taking of usury by a national bank, referring to the state law only to determine the maximum permitted rate.

The minority opinion contained a paragraph which spells out the fact that the practice of taking interest in advance increases the effective interest or yield on the note, and also the fact that as the duration of the loan goes up, the increase in effective rate or yield goes up. This explains the importance of the fact that in *Fleckner* v. *Bank of the United States*, supra, the note had 6 months to run at the time it was discounted, and the frequent references in the opinions in *Evans* v. *National Bank of Savannah*, supra, to the fact that the notes involved were "short-term" or "short-time":[25]

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[25] If interest should be taken in advance on long-term obligations, the results are startling: in the case of a 10-year note, bear-

> The difference between the effect of computing discount taken in advance according to the custom of bankers, by applying the allowed percentage to the face of the note,—termed "bank discount,"—and the effect of deducting an amount equivalent to exact interest on the sum actually loaned,—termed "true discount,"—is very substantial, and is recognized in the standard interest and discount tables, which contain computations on both bases. To illustrate by a comparison: If interest at the rate of 8 per centum per annum be reserved in advance and computed upon the face of a three months' note, it amounts to 2.0408 per cent for the period, or at the rate of 8.1632 per centum per annum upon the money loaned; upon a six months' note it amounts to 4.1667 per cent for the period, or at the rate of 8.3333 per centum per annum; upon a nine months' note, to 6.383 per cent for the period, or at the rate of 8.511 per centum per annum; upon a one-year note it amounts to 8.695 per cent.

The minority agreed that:

> under the decisions of this court and the general current of authority, the discounting of short-term notes with a reservation of interest in advance at the highest rate allowed by statute is permissible in the absence of special restrictions. Fleckner v. Bank of United States, 8 Wheat. 338, 349, 354, 5 L. ed. 631, 633, 635.

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ing 10 percent interest, the interest would equal the total amount of the note, and the borrower would receive nothing. The 365/360 basis, however, does not have this effect, regardless of the length of the loan involved.

The view of the *Fleckner* and *Evans* courts that the custom of taking interest in advance was "prevailing" or "universal" is limited to the short-term transactions involved in the cases before them, and does not apply to every type of transaction, such as a 10-year note at a 10 per cent interest rate. "Universal" and "prevailing" bank customs may be subject to considerable limitations.

The minority, however, did not consider that the customary nature of the practice, however widespread and common, could overrule the specific State prohibition of the practice, based on the *Loganville Banking Co.* decision.

It is submitted that the entire Court which decided *Evans* v. *National Bank of Savannah* would have subscribed to the following position:

A national bank may compute interest on a loan bearing the maximum legal rate permitted by State law, on a customary basis which is not prohibited by State statute or state judicial decision, even though the use of this customary basis results in a slightly higher effective interest rate or yield than the State's nominal interest rate.

This is precisely the situation in the present case. The custom of computing interest on the 365/360 basis, like the custom of taking interest in advance on short-term notes bearing the legal maximum rate, is an "ancient and commonly accepted doctrine", one "which banks generally exercise", and which is "a settled practice of banks", and one which is supported by "the general current of authority". Nothing in the Oregon Statutes or the Oregon decisions expressly prohibits the custom of using the 365/360 basis. The effective interest rate or yield resulting from use of the 365/360 basis is within the general bounds of the effective interest rate or yield resulting from taking interest in advance at periods of a year or less.

No decision subsequent to *Evans* v. *National Bank of Savannah,* supra, has been found which conflicts with the position stated above.

III

Recent Oregon and Federal Legislation Destroys Any Public Policy Arguments for an Interpretation that Would Prohibit the Use of the 365/360 Basis for the Loans Involved

The American Bankers Association takes the position that if the use of the 365/360 basis for computing interest at the maximum legal rate is to be prohibited as a matter of public policy, this change should be made by amendment to the National Bank Act or the Oregon Statutes.

No such legislation has been enacted. On the contrary, both Congress and the Oregon legislature have enacted statutes which relax their interest rate requirements.

Early in the 1970's it became clear that high interest rates elsewhere in the country were making it difficult for Oregon commercial firms to obtain funds under the 12 per cent interest ceiling and that this was interfering with Oregon's industrial growth and development. Therefore, in May 1971, the Oregon legislature enacted ORS § 82.125 to prohibit the defense of usury in any transaction involving more than $50,000. Then in 1973, Oregon amended § 82.010(4) and (5) and § 708.480(7) to permit State and national banks to charge any rate of interest on loans over $50,000, except those made to charitable and other nonprofit corporations.

On October 29, 1974, Public Law 93-501 became law, amending the National Bank Act (12 U.S.C § 85) so as to permit, for three years, on business and agricultural loans of $25,000 or more, Federally insured banks, Federally insured savings and loan associations, and small business investment companies to charge up to

5 per cent over the discount rate at the Federal Reserve bank in the district. Since the discount rate at all Federal Reserve banks was 8 per cent at the date of enactment of P.L. 93-501, this permitted interest rates up to 13 percent. (The discount rate was reduced by the Federal Reserve Bank of San Francisco on February 4, 1975 to 6¾ per cent.) The legislative history of P.L. 93-501 makes it clear that Congress was convinced that it was necessary to supersede unrealistic State usury ceilings, in order to relieve the financial industries of several States and their commercial and agricultural customers, and the customers and employees of those business firms, from the consequences of usury ceilings lower than the nationwide price of money and lower than the ceiling in neighboring States.[26]

It is submitted that this legislation precludes the suggestion that a broad interpretation of 12 U.S.C. §§ 85 and 86 which would result in a prohibition of the 365/360 basis would accord with public policy or be in the public interest.[27]

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[26] *Problems Encountered under State Usury Laws.* Hearings of a Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs, on S.3817, 93rd Congress, July 31, 1974; Senate Report No. 93-1120 on S.3838, 93d Congress, August 21, 1974.

[27] Following the decision in *Ditmars* v. *Camden Trust Company*, 10 NJ 471, 92 A.2d 12, 35 ALR2d 822 (1952), which refused to approve use of the 365/360 basis, the New Jersey Legislature specifically authorized its use when interest was taken for less than a year or paid at intervals of less than a year. New Jersey Laws of 1958, c. 150, R.S. § 31.1-1, NJSA. In *Silverstein* v. *Shadow Lawn Savings and Loan Association*, 51 NJ 30, 237 A.2d 474 (1968), it was held that this statutory authorization for the 365/360 basis does not apply to long-term amortizing mortgages.

CONCLUSION

The American Bankers Association respectfully submits that neither legal doctrine nor public policy requires or supports an interpretation of the National Bank Act which would make unlawful—and would subject to severe penalties—a banking custom which has been widely followed for more than 170 years. This Association respectfully submits that if such a change in the interpretation of, and practices under, the National Bank Act is desirable as a matter of public policy, the change should be effected by legislation—not by judicial decision.

The American Bankers Association respectfully urges that the petition for a writ of certiorari in this case be granted, and that the decision of the Court below be reversed.

Respectfully submitted,

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March 6, 1975